IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
WESTERN DIVISION

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ST. PAUL REINSURANCE COMPANY, LTD., CNA REINSURANCE COMPANY, LTD., and ZURICH REINSURANCE (LONDON) LIMITED,

Plaintiffs,

vs.

COMMERCIAL FINANCIAL CORP.,

Defendant,
____

COMMERCIAL FINANCIAL CORP. and SECURITY STATE BANK,

Counterclaim Plaintiffs,

vs.

ST. PAUL REINSURANCE COMPANY, LTD., CNA REINSURANCE COMPANY, LTD., ZURICH REINSURANCE (LONDON) LIMITED, PROFESSIONAL CLAIMS MANAGERS, INC., and U.S. RISK UNDERWRITERS, INC.,

Counterclaim Defendants.
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<td>
No. C00-4080

MEMORANDUM OPINION AND ORDER REGARDING DEFENDANT’S MOTION FOR SUMMARY JUDGMENT
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I. INTRODUCTION

This is an action for declaratory judgment pursuant to 28 U.S.C. § 2201 for the purposes of determining questions of actual controversy between the parties and construing the rights and legal relations of the parties arising from a contract of insurance entered into between St. Paul Reinsurance Company, Ltd., CNA Reinsurance Company, Ltd. and Zurich Reinsurance (London) Limited (hereinafter jointly referred to as the "London Insurers") and Commercial Financial Corp. ("CFC"). On July 24, 2000, London Insurers filed this declaratory judgment action for rescission of a contract between CFC and U.S. Risk Underwriters, Inc. ("U.S. Risk") based upon alleged material misrepresentations in the process of applying for insurance coverage.

A. Factual Background

The London Insurers are subscribing insurance companies that issue insurance policies through their managing general agent, U.S. Risk. Specifically, the London Insurers are engaged in the business of providing and underwriting insurance, including liability insurance. On October 6, 1999, CFC acquired controlling interest in First Security Banshares, Inc. Security State Bank is a wholly owned subsidiary of First Security Banshares and is comprised of twelve employees. In the sale transaction, CFC terminated three[1] Security State employees and replaced them with its own management. Thereafter, on October 13, 1999, CFC applied for employment insurance with U.S. Risk for three of its corporate entities. The corporate entities seeking insurance were CFC, Commercial Trust & Savings Bank and Central Trust & Savings Bank. At this time, Security State did not seek insurance. In its application form, U.S. Risk sought certain information regarding the prospective insureds' employees. Among other things, U.S. Risk inquired whether CFC, Commercial Trust & Savings Bank and Central Trust and Savings Bank had fired any employees during the preceding twelve months. These prospective insureds accurately responded that they had not fired anyone during the preceding twelve months.

In February of 2000, CFC requested that the insurance policy be amended by adding Security State as a named insured on the policy. On February 9, 2000, CFC's soliciting agent, Iowa Bankers Insurance and Services, Inc. ("IBIS") contacted U.S. Risk and made this request on behalf of CFC. Specifically, Connie Hansen of IBIS provided U.S. Risk with the employee count and confirmation that the new subsidiaries, namely Security State, would follow the same procedures as CFC. Additionally, Ms. Hansen asked that U.S. Risk confirm receipt and advise as soon as possible if anything else would be required to issue the endorsement. Thereafter, in February of 2000, the London Insurers issued an endorsement adding Security State as a named insured on the policy.

In March of 2000, the three former employees of Security State filed wrongful

[1]For the first time, the London Insurers, in their November 1, 2000, Surreply brief, claim that four Security State employees were terminated. For purposes of the motion, the exact number of Security State employees terminated is immaterial.

discharge claims against Security State with the Equal Employment Opportunity Commission ("EEOC"). Based upon this information, the London Insurers seek rescission of the insurance contract because it argues that CFC's failure to disclose that it terminated these three employees when it sought to amend its policy by adding Security State as a named insured on the policy constitutes fraud.

B. Procedural Background

On July 24, 2000, the London Insurers filed a declaratory judgment action against CFC seeking rescission of the insurance policy issued to CFC. The London Insurers' rescission claim is based on CFC's alleged misrepresentations and omissions of material information made in the application for the renewal of the insurance policy. Specifically, the London Insurers argue that CFC's failure to disclose the October terminations of three Security State employees in connection with the February 9, 2000, request that Security State be added to the already existing insurance policy, knowing that such information was material to the risk that the London Insurers assumed in issuing such an employment practices liability insurance policy, constitutes fraud.

On September 1, 2000, CFC moved for summary judgment on the London Insurers' declaratory judgment action for rescission of the insurance policy. In its motion for summary judgment, CFC argues that the London Insurers' claim is both factually frivolous and legally barred. With respect to the legal argument, CFC asserts the following: 1) Security State had no duty to answer questions that were not asked; 2) there is no duty to volunteer information that is not expressly and clearly requested; 3) there is no duty to supplement information after a policy is issued; and 4) the London Insurers' claims are statutorily barred. In short, CFC argues that it was under no duty to disclose any information that it was not asked by the London Insurers. In contrast, the London Insurers assert that CFC was under an affirmative duty to disclose all information relevant to the risk of being insured until the application process was completed and until the policy was actually issued and delivered by the insurer in its final form, which the London Insurers argue occurred in February of 2000 when Security State was added as a named insured on the already existing policy. The London Insurers assert that the law does not allow an insurance applicant to hide information it fully understands to be material during the application process—even if the questions concerning such material information are not specifically re-asked a second time. The London Insurers emphasize the timing of the events in this case, highlighting the following:

> 1. On October 6, 1999, CFC purchases Security State's parent company and immediately replaces numerous officers and employees of Security State with CFC's own management.
>
> 2. CFC was specifically asked on its initial application of October 13, 1999, whether the insured entity had been involved in any "involuntary terminations during the past twelve months."
>
> 3. CFC was specifically informed in the application that such information formed the "basis" of the insurance contract.
>
> 4. CFC, after receiving the subject insurance policy in November, 1999, re-opened the application process on February 9, 2000, by requesting that another, new entity be added to the existing policy—Security State Bank.
>
> 5. As of February 9, 2000, CFC and its insurance broker Iowa Bankers Insurance Services, Inc. knew:
>   i. That CFC and Security State had involuntarily terminated at least four Security employees;
>   ii. That the insurers regarded such information as material;
>   iii. That the final policy, including Security State as an insured, was not yet issued.
>
> 6. As of February 9, 2000, the banks and their insurance broker IBIS had not supplied any of the obviously material information to the insurers.

London Insurers' Resistance Brief at 8 and Surreply Brief at 4. Therefore, the London

Insurers argue that because the application process was not completed in November of 1999—it was continuing through February of 2000, because CFC and Security State themselves elected to re-open the process by adding the very bank whose employees have now brought actions against them—CFC and Security State were under a continuing duty to supplement any material inaccuracies in the application process though February, 2000. This is so, the London Insurers argue, because the application process was not concluded until the endorsement adding Security State was issued to defendants in February of 2000. In sum, the London Insurers argue that CFC and Security State, under the law, were required, as insurance applicants, to disclose any material change in the nature of the risk between the time that the application was submitted in October of 1999, and the time that the policy was issued and delivered in its final form in February of 2000.

On October 17, 2000, CFC filed its reply, and after obtaining leave from the court, the London Insurers filed a surreply on November 1, 2000. Thereafter, with permission from the court, CFC filed its response to the London Insurers' surreply on November 3, 2000. The court deems the matter fully submitted.

II. STANDARDS FOR SUMMARY JUDGMENT

This court has considered in some detail the standards applicable to motions for summary judgment pursuant to FED. R. CIV. P. 56 in a number of prior decisions. *See, e.g., Swanson v. Van Otterloo*, 993 F. Supp. 1224, 1230-31 (N.D. Iowa 1998); *Dirks v. J.C. Robinson Seed Co.*, 980 F. Supp. 1303, 1305-07 (N.D. Iowa 1997); *Laird v. Stilwill*, 969 F. Supp. 1167, 1172-74 (N.D. Iowa 1997); *Rural Water Sys. #1 v. City of Sioux Ctr.*, 967 F. Supp. 1483, 1499-1501 (N.D. Iowa 1997) *aff'd in pertinent part*, 202 F.3d 1035 (8th Cir. 2000); *Tralon Corp. v. Cedarapids, Inc.*, 966 F. Supp. 812, 817-18 (N.D. Iowa 1997), *aff'd,* 205 F.3d 1347 (8th Cir. 2000) (Table op.); *Security State Bank v. Firstar Bank Milwaukee, N.A.*, 965 F. Supp. 1237, 1239-40 (N.D. Iowa 1997); *Lockhart v. Cedar Rapids*

Community Sch. Dist., 963 F. Supp. 805 (N.D. Iowa 1997). Thus, the court will not consider those standards in detail here. Suffice it to say that Rule 56 itself provides, in pertinent part, as follows:

> Rule 56. Summary Judgment
>
> (a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in the party's favor upon all or any part thereof.
>
> (b) For Defending Party. A party against whom a claim . . . is asserted . . . may, at any time, move for summary judgment in the party's favor as to all or any part thereof.
>
> (c) Motions and Proceedings Thereon. . . . *The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.*

FED. R. CIV. P. 56(b) & (c) (emphasis added).

Applying these standards, the trial judge's function at the summary judgment stage of the proceedings is not to weigh the evidence and determine the truth of the matter, but to determine whether there are genuine issues for trial. *Quick v. Donaldson Co.*, 90 F.3d 1372, 1376-77 (8th Cir. 1996); *Johnson v. Enron Corp.*, 906 F.2d 1234, 1237 (8th Cir. 1990). Therefore, a court considering a motion for summary judgment must view all the facts in the light most favorable to the nonmoving party, and give the non-moving party the benefit of all reasonable inferences that can be drawn from the facts. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986) (quoting *United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1962)). An issue of material fact is genuine if it has a real basis in the record. *Hartnagel v. Norman*, 953 F.2d 394, 395 (citing *Matsushita Elec.*

Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 586-87 (1986)). As to whether a factual dispute is "material," the Supreme Court has explained, "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986); *Beyerbach*, 49 F.3d at 1326; *Hartnagel*, 953 F.2d at 394. Furthermore, "[w]here the unresolved issues are primarily legal rather than factual"—as the parties assert is the case here—"summary judgment is particularly appropriate." *Arnold v. City of Columbia, Mo.*, 197 F.3d 1217, 1220 (8th Cir. 1999) (citing *Crain v. Board of Police Commissioners*, 920 F.2d 1402, 1405-06 (8th Cir. 1990)); *Haberer v. Woodbury County, Ia.*, 188 F.3d 957, 961 (8th Cir. 1999) (also citing *Crain*); *Cearley v. General Am. Transp. Corp.*, 186 F.3d 887, 889 (8th Cir. 1999) (same). With these standards in mind, the court turns to consideration of CFC's motion for summary judgment.

III. LEGAL ANALYSIS

It is solely on the element of a duty to disclose that CFC has moved for summary judgment. CFC asserts that when an insurer fails to ask a particular question, the insurer—not the insured—assumes the risks concerning the subject about which the insurer did not inquire. Therefore, CFC argues that because the London Insurers failed to ask whether any Security State employees had been terminated within the previous year by CFC or Security State when it sought to amend the policy in February of 2000, the London Insurers assumed this risk when underwriting the policy. Consequently, CFC argues that the London Insurers cannot now rescind the insurance policy based on a failure to disclose the terminations because CFC and Security State were under no duty to disclose such information.

A. Fraudulent Non-disclosure In Equity

The Iowa Supreme Court has recognized that, in an equity case, "[a]s a general rule, fraudulent misrepresentations leading to the creation of a contract give rise to a right of rescission." *Robinson v. Perpetual Serv. Corp.*, 412 N.W. 2d 562, 568 (Iowa 1987) (citing *Midwest Management Corp. v. Stephens*, 291 N.W. 2d 896, 906 (Iowa 1980) and *Maytag Co. v. Alward*, 112 N.W. 2d 654, 659-60 (1962)); *First Nat'l Bank in Lenox v. Brown*, 181 N.W. 2d 178, 182 (Iowa 1970) ("It is a well settled principle of equity that misrepresentations amounting to fraud in the inducement of a contract, whether innocent or not, give rise to a right of avoidance on the part of the defrauded party."). That is not the extent of the remedies available in equity, however:

> Parties seeking rescission are entitled to restitution for expenses incurred under the contract, but as a result of the election to rescind ordinarily cannot also recover contract damages. *Maytag*, 112 N.W.2d at 659-60; *Miller-Piehl Equip. Co. v. Gibson Comm'n Co.*, 56 N.W. 2d 25, 29 (1952).

Robinson, 412 N.W. 2d 562 at 568. These decisions make clear that rescission is essentially an equitable remedy for fraudulent misrepresentation, but that it must be obtained by making a claim for rescission in equity and proving the fraud, including proof of the five elements identified below by the standard stated below.

The elements a plaintiff must prove to prevail on a claim of fraudulent misrepresentation in equity in Iowa are the following: (1) a representation, (2) falsity, (3) materiality, (4) intent to induce the plaintiff to act or refrain from acting, (5) reliance. *Utica Mutual Ins. Co v. The Stockdale Agency*, 892 F. Supp. 1179, 1195 (N.D. Iowa 1995); *see also Hyler v. Garner*, 548 N.W. 2d 864, 871-72 (Iowa 1996) (noting with approval this court's decision in *Utica* and adopting this court's formulation of the "intent" element in an equity action for rescission based on misrepresentation, outlined in *Utica*, as well as this court's rationale for that formulation). Moreover, in equity, fraud may be proved by circumstantial evidence. *Wilden Clinic, Inc*., 229 N.W. 2d at 292 (clarifying the differences between proof of fraud at law and in equity and stating that in equity "fraud may arise from facts and circumstances, and an intent to defraud may properly be inferred from circumstances, words, and actions shown in evidence"); *First Nat'l Bank in Lenox*, 181 N.W. 2d at 181; *Smith v. Peterson*, 282 N.W. 2d 761, 766 (Iowa Ct. App. 1979) (citing *Wilden Clinic, Inc*.).

The Iowa Supreme Court clarified the meaning of the first three elements of fraud in either equity or law proceedings in *Sinnard v. Roach*, 414 N.W. 2d 100, 105 (Iowa 1987). The court observed, first, that "[t]he three elements . . . are a (1) material (2) representation that is (3) false," and that they are "frequently treated as a single element and referred to as fraudulent misrepresentation." *Sinnard*, 414 N.W. 2d at 105; *Cf. Air Host Cedar Rapids v. Cedar Rapids Airport Comm'n*, 464 N.W. 2d 450, 453 (Iowa 1990) (telescoping the first three elements as "a material misrepresentation"); *Kristerin Dev. Co. v. Granson Investment*, 394 N.W. 2d 325, 332 (Iowa 1986); *Beeck v. Aquaslide 'N' Dive Corp.*, 350 N.W. 2d 149, 155 (Iowa 1984) (same); *Beeck v. Kapalis*, 302 N.W. 2d 90, 94 (Iowa 1981); *see also Ryko Mfg. Co. v. Eden Servs*., 823 F.2d 1215, 1237 (8th Cir. 1987) (same). The court next noted that "[a] representation need not be an affirmative misstatement; it can arise as easily from a failure to disclose material facts." *Id.* (citing *Cornell v. Wunschel*, 408 N.W. 2d 369, 374 (Iowa 1987)). The court stated that to be actionable, the misrepresentation must "'relate to a material matter known to the party . . . which it is his legal duty to communicate to the other contracting party whether the duty arises from a relation of trust, from confidence, from inequality of condition and knowledge, or other attendant circumstances.'" *Id.* (quoting *Wilden Clinic, Inc*., 229 N.W. 2d at 293, and also citing *Cornell*, 408 N.W. 2d at 374).

Moreover, in *Cornell*, the Iowa Supreme Court considered defendant's proffered paraphrase of several of the elements of the fraud or fraudulent misrepresentation claim as an "affirmative misstatement of fact by defendant [ ] calculated to induce [the plaintiff] to enter into [a contract or agreement]." *Cornell*, 408 N.W. 2d at 374. However, the court found that either "[c]oncealment of or failure to disclose a material fact can constitute fraud in Iowa. . . .To be actionable, the concealment must be by a party under a duty to communicate the concealed fact." *Id.* (citations omitted). CFC argues that summary judgment is appropriate in this case because neither it nor Security State was under a duty to communicate that Security State employees had been terminated within the past twelve months.

1. Duty to Disclose

The general rule is that an applicant for insurance has no duty to disclose information about which the insurer has not inquired. *See Newton v. Southwestern Mut. Life Ass'n*, 90 N.W. 73, 75-76 (Iowa 1902); *Serv. Life Ins. of Omaha*, 13 N.W. 2d 440, 443-44 (Iowa 1944); *Parker v. Iowa Mut. Tornado Ins. Ass'n.*, 260 N.W. 844, 848 (Iowa 1935); *see also Aetna Casualty & Surety Co. v. Retail Local 906 of AFL-CIO Welfare Fund*, 921 F. Supp. 122, 132 (E.D.N.Y. 1996) (stating that an applicant is under no duty to volunteer information where no question plainly and directly requires it to be furnished); *First Financial Ins. Co. v. Allstate Interior Demolition Corp.*, 193 F. 3d 109, 118 (2nd Cir. 1999) (stating that an applicant is ordinarily permitted to remain silent on matters concerning which he is not questioned); *Cosby v. Transamerica Occidental Life Ins. Co.*, 860 F. Supp. 830, 833 (N.D. Ga. 1993) ("The general rule is that an applicant for insurance has no duty to disclose information about which the insurer has not inquired."). However, where the non-disclosure, as to a matter which the insured has not been directly asked, constitutes fraud, the policy may be voided. *National Aviation Underwriters, Inc. v. Fischer*, 386 F.2d 582, 584 (8th Cir. 1967) ("The general rule is that absent fraud an applicant's failure to disclose facts about which no questions were asked will not avoid the policy."); *Wharton v. Aetna Life Ins. Co.*, 48 F.2d 37, 44 (8th Cir. 1931) (" In the absence of fraud, the applicant's failure to disclose facts about which no questions are asked will not avoid a policy."); *Business Men's Assur. Co. v. Campbell,* 32 F.2d 995, 997 (8th Cir. 1929) (same); *see also Atlantic Mut. Ins. Co. v. Balfour MacLaine Int'l,* 85 F.3d 68, 81 (2d Cir. 1996) (applying New York law and stating that absent fraud, the insured's failure to disclose a fact about which it was not asked is not grounds for avoiding the policy); *Home Ins. Co. of Ill. v. Spectrum Information. Technologies Inc.,* 930 F. Supp. 825, 840 (E.D.N.Y. 1996) (stating that the duty to disclose is not so limited to information requested in an insurance application where nondisclosure would be tantamount to fraudulent concealment); *Aetna Casualty and Surety Co. v. Retail Local 906 of AFL-CIO Welfare Fund,* 921 F. Supp. 122, 132 (E.D.N.Y. 1996) ("[W]here the nondisclosure, as to a matter which the insured has not been directly asked, constitutes fraud, the policy may be voided."); *Putnam Resources v. Pateman et al.,* 757 F. Supp. 157, 162 (D.R.I. 1991) (parties noting that absent fraud, an insured only has a duty to disclose information about which an insurer requires). Indeed, the Eighth Circuit Court of Appeals, in *General Reinsurance Corp. v. Southern Surety Co. of Des Moines*, 27 F.2d 265 (8th Cir. 1928), was presented with the question of whether a party was liable for wrongful and fraudulent concealment of material facts. Upon stating that the "strictest duty of good faith is required on the part of one seeking original insurance" and that "the duty exists on the part of each to disclose his knowledge of all material facts," the Eighth Circuit Court of Appeals quoted from several state cases, one of which is especially relevant to the inquiry here:

> We think the modern tendency . . . is to require that a nondisclosure of a fact not inquired about shall be fraudulent, before vitiating the policy. . . . *Penn Mut. Life Ins. Co. v. Mechanics' Savings Bank & Trust Co.,* 72 F. 413 (6th Cir. 1896).

General Reinsurance Corp., 27 F.2d at 271-73. Thus, as these decisions demonstrate, the general rule is that, absent fraud, an applicant for insurance has no duty to disclose information about which the insurer has not inquired. Accordingly, CFC is correct insofar as it asserts that it was under no duty to disclose information to the London Insurers that the London Insurers failed to ask. However, because the London Insurers allege fraudulent non-disclosure against CFC, CFC may have been under a duty to disclose. *See National Aviation Underwriters, Inc.*, 386 F.2d at 584 ("The general rule is that <u>absent fraud</u> an applicant's failure to disclose facts about which no questions were asked will not avoid the policy.") (emphasis added).

2. Was CFC under a duty to disclose?

As stated above, Iowa law recognizes that "[a] representation need not be an affirmative misstatement; the concealment of or failure to disclose a material fact can constitute fraud." *Clark v. McDaniel*, 546 N.W. 2d 590, 592 (Iowa 1996) (citing *Sinnard v. Roach*, 414 N.W. 2d 100, 105 (Iowa 1987) and *Cornell v. Wunschel*, 408 N.W. 2d 369, 374 (Iowa 1987). However, as the Iowa Supreme Court has observed,

> for concealment to be actionable, the representation must "relate to a material matter known to the party . . . which it is his legal duty to communicate to the other contracting party whether the duty arises from a relation of trust, from confidence, from inequality of condition and knowledge, or other attendant circumstances." *Sinnard*, 414 N.W. 2d at 105 (quoting *Wilden Clinic, Inc. v. City of Des Moines*, 229 N.W. 2d 286, 293 (Iowa 1975)).

Clark, 546 N.W. 2d at 592; *McGough v. Gabus*, 526 N.W. 2d 328, 331 (Iowa 1995) (fraud may arise from a special relationship giving rise to a duty to disclose and failure to make that disclosure). The Iowa Civil Jury Instructions describe the duty element for fraudulent nondisclosure as follows: Special circumstances existed which gave rise to a duty of disclosure between the plaintiff and the defendant. (Describe the relationship found to give rise to a duty of disclosure.). Iowa Civil Jury Instructions, 810.2 (citing *Air Host Cedar*

Rapids v. Cedar Rapids Airport Comm'n, 464 N.W.2d 450, 453 (Iowa 1990); *Sinnard*, 414 N.W. 2d at 100; *Cornell*, 408 N.W. 2d at 369; *Kunkle Water & Elec. Inc. v. City of Prescott*, 347 N.W. 2d 648 (Iowa 1984); Restatement (Second) of Torts § 551; and *American Family Serv. Corp. v. Michelfelder*, 968 F.2d 667 (8th Cir. 1992)). The Comment to Iowa Civil Jury Instruction 810.2 states,

> Whether the special circumstances are such as to give rise to a duty of disclosure is generally a question of law for the Court. Restatement (Second) of Torts Section 551, Comment m (1977). Whether such special circumstances exist is a question of fact for the jury.

Iowa Civil Jury Instructions, 810.2, Comment. The comment from the Restatement (Second) of Torts § 551 identified states as follows:

> m. Court and jury. Whether there is a duty to the other to disclose the fact in question is always a matter for the determination of the court. If there are disputed facts bearing upon the existence of the duty, as for example the defendant's knowledge of the fact, the other's ignorance of it or his opportunity to ascertain it, the customs of the particular trade, or the defendant's knowledge that the plaintiff reasonably expects him to make the disclosure, they are to be determined by the jury under appropriate instructions as to the existence of the duty.

Restatement (Second) of Torts § 551, comment m. For purposes of this motion, the court need only decide whether the circumstances asserted, if proved, would be sufficient to give rise to a duty to disclose.

This court, in *Jones Distrib. Co., Inc. v. White Consol. Indus., Inc.*, 943 F. Supp. 1445, 1474- 1478 (N.D. Iowa 1996), discussed the various tests used to determine when a duty to disclose arises. The Iowa Supreme Court has provided some guidance, stating:

> [t]here is no specific test for determining when a duty to reveal arises in fraud cases. *Sinnard*, 414 N.W. 2d at 106. However, we have stated that [a] misrepresentation may occur

> when one with superior knowledge, dealing with inexperienced persons who rely on him or her, purposely suppresses the truth respecting a material fact involved in the transaction. *Kunkle Water & Elec., Inc. v. City of Prescott*, 347 N.W. 2d 648, 653 (Iowa 1984); *see also Sinnard*, 414 N.W. 2d at 106 (applying the *Kunkle* analysis).

Clark, 546 N.W. 2d at 592; *accord Cornell*, 408 N.W. 2d at 374 (stating that the duty arises from a relation of trust, from confidence, from inequality of condition and knowledge, or other attendant circumstances). The London Insurers argue that due to the parties' inequality of knowledge, a duty to reveal arose in this case. The court agrees. It is undisputed that CFC and Security State had superior knowledge concerning whether they terminated any employees within the time period specified by the insurance contract. CFC argues, however, that the London Insurers, as the insurer, with its vast knowledge of insurance has a greater knowledge of the information it wishes to receive and deems material, and, therefore, the insured should not be held responsible for the London Insurers' failure to ask for such information. The court is cognizant that the London Insurers hardly qualify as an "inexperienced person" in matters of insurance contracts, however, this argument ignores the undisputed evidence that, the London Insurers did, in fact, ask CFC in the October 13, 1999, application, whether it or Commercial Trust & Savings Bank and Central Trust & Savings Bank had terminated any employees within the past twelve months. This information was, therefore, deemed material by the London Insurers due in large part to the fact that it was issuing employment practices liability insurance, which provides, *inter alia*, coverage for wrongful dismissal claims. Accordingly, because the undisclosed information was available only to CFC and Security State as it was "peculiarly within the knowledge" of CFC and Security State, *see First Nat'l Bank in Lenox*, 181 N.W. 2d at 183, such inequality of knowledge would be sufficient to give rise to a duty to disclose.

Moreover, the Restatement (Second) of Torts § 551 and comments thereto, which specifically deal with liability for non-disclosure and delineate other tests that are used in determining when a duty to disclose arises, provides:

§ 551. Liability for Nondisclosure

> (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.
>
> (2) One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated,
>
> (a) matters known to him that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them; and
>
> (b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; and
>
> (c) subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so; and
>
> (d) the falsity of a representation not made with the expectation that it would be acted upon, if he subsequently learns that the other is about to act in reliance upon it in a transaction with him; and
>
> (e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.

Restatement (Second) of Torts § 551. The court finds that the London Insurers have asserted circumstances that fall within at least one of these identifications of when a duty of disclosure arises in a business relationship, namely § (2)(e)—"facts basic to the transaction." Comment j states, in pertinent part, the following:

> A basic fact is a fact that is assumed by the parties as a basis

> for the transaction itself. It is a fact that goes to the basis, or essence, of the transaction, and is an important part of the substance of what is bargained for or dealt with. Other facts may serve as important and persuasive inducements to enter into the transaction, but not go to its essence. These facts may be material, but they are not basic. If the parties expressly or impliedly place the risk as to the existence of a fact on one party or if the law places it there by custom or otherwise the other party has no duty of disclosure.

The London Insurers argue that CFC and Security State's alleged non-disclosure regarding the involuntary terminations went to the root of their insurability. The London Insurers point out that CFC sought coverage for, *inter alia*, wrongful dismissal claims, and, therefore, because it knew the materiality of such information, having been asked this exact question in its initial application for coverage on October 13, 1999, CFC and Security State's failure to inform the London Insurers that three Security State employees had been fired within the past twelve years when it sought to amend the policy by adding Security State as a named insured on the policy are facts that go directly to the essence of the transaction and are an important part of what was bargained for, *to wit*: employment practices liability insurance. The London Insurers assert that had CFC and Security State disclosed that three employees had been terminated, including one who was physically disabled and one who was of advanced age, that the London Insurers would have refused to provide coverage for any claims arising from those dismissals. At the very least, the London Insurers argue that this information would have affected the London Insurers' risk in issuing employment practices liability insurance to Security State. The London Insurers further state that a record of terminating employees by CFC and Security State was the most critical factor considered by it in deciding whether it would issue an insurance policy to provide coverage for wrongful terminations.

This court is persuaded that a record of terminating employees by CFC and Security State, while perhaps not the most critical factor, was undoubtedly, in this court's opinion, a basic fact that went to the essence of the London Insurers issuing employment practices liability insurance to Security State. Consequently, the court finds, as a matter of law, that the circumstances asserted by the London Insurers, if proved, would give rise to a duty to disclose by CFC and Security State that Security State employees had been terminated within the past twelve months.

B. Is the London Insurers' claim statutorily barred?

In its motion for summary judgment, CFC also claims that the London Insurers' claim is barred by Iowa Code § § 515.94 and 515.95. Specifically, CFC argues that these sections mandate that if a representation affects the validity of an insurance policy, such representation must be provided to the insured. Here, because no representations regarding CFC or Security State's failure to disclose involuntary terminations within the past twelve months were provided to CFC, CFC argues that Iowa Code § § 515.94 and 515.95 bar the London Insurers' attempt to set aside CFC's policy.

Section 515.94 provides that:

> All insurance companies or associations shall, upon issuance of any policy or renewal, provide to the insured, a true copy of any application or representation of the insured which, by the terms of the policy, is made part of the policy, or of the contract of insurance, or referred to in the contract of insurance, or which in any manner may affect the validity of the policy.

Iowa Code § 515.94. Section 515.95 provides:

> The omission so to do shall not render the policy invalid, but if any company or association neglects to comply with the requirements of section 515.94 it shall forever be precluded from pleading, alleging, or proving any such application or representations, or any part thereof, or falsity, or any parts thereof, in any action upon such policy, and the plaintiff in any such action shall not be required, in order to recover against such company or association, either to plead or prove such

> application or representation, but may do so at the plaintiff's option.

Iowa Code § 515.95. The purpose of these two sections is to guarantee that the insured is "in possession of the evidence of what his contract is." *Dohse v. Market Mens Mut. Ins. Co.*, 115 N.W. 2d 844, 847-48 (Iowa 1962); *Utica*, 892 F. Supp. 1179 at 1201 (stating that, under Iowa law, an application for insurance becomes part of the insurance contract by virtue of the Iowa Code § 515.94 where the application is made a part of the contract); *Johnston Equip. Corp. v. Industrial Indem.*, 489 N.W. 2d 13, 16-18 (Iowa 1992) (stating that the purpose of Iowa Code § 515.95 is to make certain that the writings composing the [policy] may all appear together and the insured may be in possession of the evidence of what [the policy provides]). These statutes have been construed very strictly by the Iowa Supreme Court and by federal courts applying Iowa law to mean that an insurance company cannot rely defensively on the falsity of a statement in an application or on a condition set out in an application unless the signed application or an exact copy is attached to the policy. *Commercial Ins. Co. of Newark v. Burnquist*, D.C., 105 F. Supp. 920, 932 (N.D. Iowa 1952).

Here, the court finds that the London Insurers did, in fact, comply with these two sections. The initial application was appended to the initial policy upon delivery in November, 1999, prior to CFC's request that Security State be added to the policy. Notwithstanding, CFC argues that the London Insurers failed to supply CFC with the representation upon which the London Insurers rely in order to void the insurance policy, *to wit*: the number of employees Security State terminated within the past twelve months. Under these set of circumstances, however, the court finds that it would be virtually impossible for the London Insures to supply CFC with such representation because the London Insurers assert that CFC failed to disclose material information; rather than affirmatively misrepresent such information. The London Insurers point out that because

CFC was in possession of the insurance application, CFC was therefore aware that such material information regarding Security State's involuntary terminations within the past twelve months was omitted, particularly in light of the proviso in the policy at issue dealing with "Representations" which, in pertinent part, provides:

> The INSURED(S) agree that the statements made in the Application are the representations and warranties of the INSURED(S); that such statements are true; that such statements shall be deemed material to the acceptance of the risk or the hazard assumed by the Underwriters under this Policy; and this Policy is issued in reliance upon the truth and accuracy of such representations.
>
> The INSURED(s) agree that, in the event that the Application contains misrepresentations or <u>fails to state facts which materially affect either the acceptance of the risk or the hazard assumed by the Underwriters under this Policy, this Policy in its entirety, shall be void and of no effect whatsoever</u>.

Insurance Policy at 9 (emphasis added). Thus, the London Insurers argue that because this action does not involve proof of representations, as contemplated by § 515.94, but, instead, concealment of material facts, these above-mentioned sections do not bar their claim. The court agrees. Based on the fact that the London Insurers allege fraudulent non-disclosure as opposed to fraudulent misrepresentation, it did comply, to the extent that it could, with Iowa Code § § 515.94 and 515.95. Accordingly, the court concludes that London Insurers' claim is not statutorily barred.

IV. CONCLUSION

Therefore, the court concludes that the London Insurers have asserted circumstances that, if proved, would give rise to a duty to disclose. Accordingly, CFC's motion for summary judgment based on the legal argument that it had no duty to disclose information relating to the termination of Security State employees within the past twelve months is **denied**. Furthermore, the court rejects CFC's assertion that the London Insurers' claim is statutorily barred by Iowa Code § § 515.94 and 515.95. Therefore, CFC's motion for summary judgment is **denied**.

IT IS SO ORDERED.

DATED this 20th day of November, 2000.

MARK W. BENNETT
CHIEF JUDGE, U. S. DISTRICT COURT
NORTHERN DISTRICT OF IOWA